Exhibit 28

S&P Global
Market Intelligence

SolarWinds Corporation NYSE:SWI

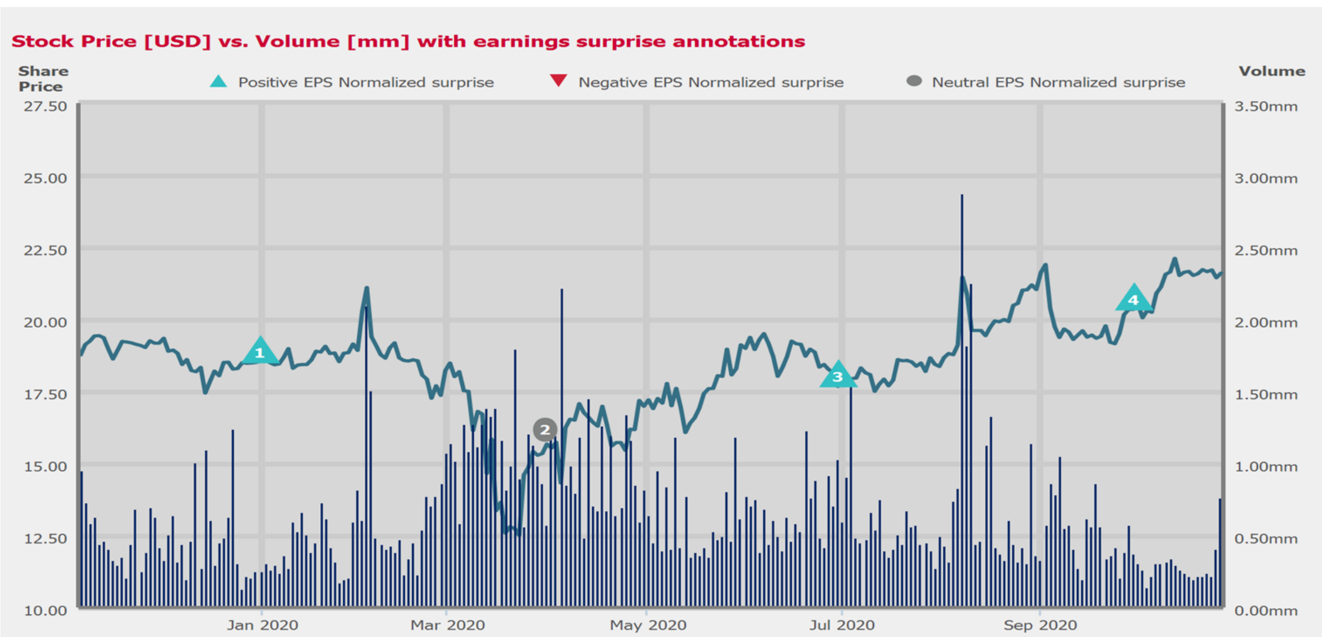
FQ3 2020 Earnings Call Transcripts

Tuesday, October 27, 2020 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2020-			-FQ4 2020-		-FY 2020-		-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE	CONSENSUS	GUIDANCE	CONSENSUS
EPS Normalized	0.24	0.28	▲16.67	0.25	0.25	0.94	0.98	1.04
Revenue (mm)	256.62	261.28	▲1.82	262.14	-	1014.07	-	1114.14

Currency: USD
Consensus as of Oct-24-2020 4:10 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2019	0.22	0.24	▲9.09 %
FQ1 2020	0.20	0.20	0.00 %
FQ2 2020	0.20	0.25	▲25.00 %
FQ3 2020	0.24	0.28	▲16.67 %

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Call Participants

EXECUTIVES

Howard Ma
Senior Director of Investor Relations

J. Barton Kalsu
Executive VP, CFO & Treasurer

John Pagliuca
Executive VP & President of MSP

Kevin B. Thompson
President, CEO & Director

ANALYSTS

Brad Alan Zelnick
Crédit Suisse AG, Research Division

Erik Loren Suppiger
JMP Securities LLC, Research Division

Luv Bimal Sodha
Jefferies LLC, Research Division

Matthew George Hedberg
RBC Capital Markets, Research Division

Mohit Gogia
Barclays Bank PLC, Research Division

Robert Cooney Oliver
Robert W. Baird & Co. Incorporated, Research Division

Sanjit Kumar Singh
Morgan Stanley, Research Division

Terrell Frederick Tillman
Truist Securities, Inc., Research Division

Unknown Analyst

William Kingsley Crane
Joh. Berenberg, Gossler & Co. KG, Research Division

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the SolarWinds Third Quarter 2020 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions] I would now like to hand the conference over to your speaker today, Howard Ma, Senior Director, Investor Relations. Thank you. Please go ahead.

Howard Ma
Senior Director of Investor Relations

Thank you, operator. Good afternoon, everyone, and welcome to SolarWinds' Third Quarter 2020 Earnings Call. With me today are Kevin Thompson, our President and CEO; Bart Kalsu, EVP and Chief Financial Officer; and John Pagliuca, EVP and President of our MSP business. Following prepared remarks, we'll have a brief question-and-answer session. This call is being simultaneously webcast on our Investor Relations website at investors.solarwinds.com.

On our Investor Relations website, you can also find our earnings press release and a summary slide deck, which is intended to supplement our prepared remarks during today's call. Please remember that certain statements made during this call are forward-looking statements, including those concerning our financial outlook, our market opportunities, the impact of the global economic environment on our business and the updates of the potential spinoff of our MSP business. These statements are based on currently available information and assumptions, and we undertake no duty to update this information except as required by law. These statements are also subject to a number of risks and uncertainties including the numerous risks related to the potential spin-off of our MSP business into a newly created and separately traded public company. Additional information concerning these statements and the risks and uncertainties associated with them is highlighted in today's earnings release and in our filings with the SEC. Copies are available from the SEC or on our Investor Relations website.

Furthermore, we will discuss various non-GAAP financial measures on today's call. Unless otherwise specified, when we refer to these financial measures, we will be referring to non-GAAP financial measures. A reconciliation of differences between GAAP and non-GAAP financial measures discussed on today's call are available in our earnings press release and summary slide deck on the Investor Relations page of our website.

And with that, I'll now turn the call over to Kevin.

Kevin B. Thompson
President, CEO & Director

Thanks, Howard. I'm pleased to report that we're able to deliver a strong performance in the third quarter, exceeding the high end of our outlook for total revenue and EBITDA in addition to delivering solid year-over-year top line growth of 8% in the face of what has continued to be a volatile and uncertain economic environment.

Total non-GAAP revenue for the third quarter, which was driven by improved sales to new customers over the second quarter and solid customer retention rate, was approximately $261 million. In addition, we delivered an exceptional quarter of profitability, generating approximately $133 million in adjusted EBITDA, meaningfully exceeding the high end of our outlook and reflecting a 51% adjusted EBITDA margin, which is the highest level of non-GAAP profitability we have delivered in the last 11 quarters.

As we saw in the second quarter, the volatility of the economic environment has resulted in a business rhythm that is less linear than our historical average. However, we did see signs of improvement in linearity and in stabilization of performance in the third quarter across selected geographies and areas of the market as compared to the second quarter. From a geographic region perspective, in the third quarter, we saw the most meaningful improvement in performance in EMEA followed by North America.

We had several operational highlights in the third quarter that I want to briefly mention. First, as you should remember, in late April, we launched subscription pricing options for each of the key offerings in our Orion family of network systems and innovative management products. And we had a good initial quarter of subscription sales of these products in the second quarter. The momentum continued into the third quarter with a sequential doubling of the dollar amount of subscription sold of these products. We currently believe we will see another strong quarter of sequential growth in subscription sales of the Orion product family in the fourth quarter.

Second, we were able to drive solid ARR growth in the third quarter with total ARR reaching approximately $887 million as of September 30, 2020, reflecting year-over-year growth of 11%. Subscription ARR grew at a meaningly faster rate of 20%, reaching $411 million at the end of the quarter.

Third, we continue to see solid growth in a number of our large customer relationships despite the difficult economic environment. This is illustrated with a number of customers who spent over $100,000 with us on a trailing 12-month basis, increasing on a year-over-year basis by 17% to 1,004 customers. And finally, customer retention rates across our product portfolio have remained strong with maintenance renewal rates of 92% in the third quarter and subscription net retention rates stable at 105%.

The last thing I will cover before turning the call over to Bart is of a more strategic nature related to our database management product portfolio. As I have indicated on several occasions over the last year, we believe that database management and operations is a large market opportunity for SolarWinds. This opportunity is being driven by digital transformation and the move to hybrid cloud infrastructures and the recognition by database administrators as well as DevOps pros of the need for greater visibility or observability into the performance of the critical applications upon which the business relies.

In order to get a complete view of application performance, visibility into database performance is required. We moved into the database management market in 2013 and have created a meaningful presence in this market for SolarWinds during the last years 7 years. Over the last year, we have been investing in broadening our capabilities to monitor and manage the performance of databases of all types, including the historical Oracle, [partial] SQL and MySQL traditional databases; as well as the newer databases such as MongoDB, Cassandra, Red Hat and Microsoft Azure SQL to name a few. This increased investment in database management started with the acquisition of VividCortex in December 2019, a leading cloud-based provider of database performance management technology, which brought us the ability to manage many of the cloud-native databases which we manage today as well as the ability to provide these management services from the cloud.

As I assume most of you saw, on last Friday after market close, we announced that we have continued to build on these capabilities through the planned acquisition of SentryOne, a leading technology provider of database performance monitoring and data operation solutions for Microsoft SQL Server, Microsoft Azure SQL and the Microsoft Data Platform for a cash purchase price of approximately $142 million.

The SentryOne offering complement and broaden on-premise, native cloud and hybrid database management offerings that we currently have and are a great fit with our product portfolio. I want to take this opportunity to welcome the SentryOne team to the SolarWinds family. We are excited about the expertise that you bring in this fast growth part of our business. We believe after this acquisition closes, which is expected to occur this week, we will provide the broadest and deepest level of database monitoring and management coverage in the on-premise, hybrid IT and native cloud infrastructure and application management markets.

With that, I will turn the call over to Bart, who will provide some additional details on our third quarter performance as well as our outlook for the fourth quarter and full year.

J. Barton Kalsu
Executive VP, CFO & Treasurer

Thanks, Kevin, and thanks again to everyone joining us on today's call. The third quarter was solid across our key performance metrics given the volatility of the current economic environment and reflected a sequential improvement from the second quarter. The combination of our uniquely high level of

profitability and focus on conversion of adjusted EBITDA to free cash flow continue to pay dividends in the third quarter as our total cash balance reached $425 million at September 30 as compared to $173 million at December 31, reflecting an increase of over $250 million. Our net leverage has consistently declined over the first 9 months of 2020 and is now at 3.1x our trailing 12 months adjusted EBITDA.

Moving on to our financial results. We had a very strong quarter of profitability, as Kevin said, in the third quarter. Adjusted EBITDA was $132.7 million, reflecting year-over-year growth of 15% and was nearly $11 million better than the high end of our outlook for the third quarter. The sequential increase of approximately 3 percentage points of adjusted EBITDA margin from the second quarter and 6 percentage points compared to the first quarter was driven by continued disciplined expense management across our global business, lower-than-planned variable sales and marketing expenses, lower headcount numbers than planned as a result of slowdown in hiring due to the pandemic and strong cash collection activity, which resulted in minimal bad debt expense. We do not expect adjusted EBITDA margins to remain at quite a bit high of a level in the fourth quarter as we are planning to reaccelerate our go-to-market spending and hiring across the business as economic equity improves.

We drove approximately $108 million in unlevered free cash flow in the third quarter, which puts our unlevered free cash flow for the 9 months ended September 30 at $312 million and reflects a year-to-date conversion rate of 86%. Our conversion rate declined sequentially compared to the second quarter primarily as a result of U.S. Federal income tax payments totaling $24 million, which were made in the third quarter. Earnings per share on a non-GAAP basis for the third quarter totaled $0.28 per share based on 316.7 million fully diluted shares outstanding.

Switching over to revenue for the quarter. Total non-GAAP revenue was $261.3 million, which was an increase of 8% compared to the prior year and above the outlook that we provided for the third quarter of $254 million to $259 million of total non GAAP-revenue.

Total non-GAAP license and maintenance revenue in the third quarter grew by 2% year-over-year, reaching $160.4 million on a reported basis. This growth was led by non-GAAP maintenance revenue which increased by approximately 7%, reaching $121.1 million. Non-GAAP license revenue in the third quarter totaled $39.3 million, reflecting a year-over-year decrease of approximately 10%.

Our license sales performance was a meaningful improvement from the second quarter. When you adjust for the subscription sales of our on-premise-based products, license revenue would have been down only 5% on a year-over-year basis for the third quarter. We expect the economic environment in the fourth quarter to be similar to that in the third quarter. And as a result, we do continue to expect some year-over-year decline in license revenue in the fourth quarter. In addition, Orion product portfolio subscription sales are expected to be a headwind to license revenue growth of approximately 4 percentage points in the fourth quarter.

During the third quarter, 85% of our total revenue was recurring and recognized as either maintenance or subscription revenue. Total non-GAAP recurring revenue for the third quarter grew at 12%, reaching $222 million. Third quarter recurring revenue growth was led by non-GAAP subscription revenue of $101 million, which grew 18% year-over-year and with approximately $100 million on a constant currency basis, reflecting year-over-year growth of 17%.

As we have communicated in the past, well over 50% of our subscription revenue is attributable to our MSP business. As we explore the potential spin-off of this business, we want to give John Pagliuca, who has led our MSP business over the last 4.5 years and who would assume the CEO role of the stand-alone entity if the spinoff is completed, an opportunity to give more context around the 2020 operating trends of our MSP business. I will now turn the call over to John.

John Pagliuca
Executive VP & President of MSP

Thanks, Mark. I'll spend the next few minutes discussing our Q3 and year-to-date performance and key trends in the industry. I believe most of the research analysts and investors on this call are familiar with our MSP business. But for those listeners who are less familiar, our MSP business refers to our technology

platform and purely software-based solution that we provide to MSPs. MSPs, or managed service providers, are a critical type of IT service provider that assume responsibility for managing and protecting the customers' IT system and services and in many cases, act as outsourced IT departments from lighting of businesses around the world. These MSPs use our technology to manage the IT environment of over 500,000 small- and medium-sized businesses in all parts of the world, monitoring, managing and securing their customers' devices and applications as well as managing disparate end user environments through our centralized dashboard.

But by nature of our business, we operate behind the scenes of our MSP partners. And as part of the larger SolarWinds parent, we thrived under relative obscurity to those outside of the MSP market. We currently expect our MSP business to generate slightly over $300 million of non-GAAP revenue in 2020, of which half about -- about half of which is outside of the U.S. And we've done this with what we believe are best-in-class gross margin and profit margin for a cloud-based business driven by our efficient operating model.

We've been growing at a CAGR of 16% on a constant currency basis since the first quarter of 2018. And year-to-date 2020, we've grown non-GAAP revenue 15% on a constant currency basis and 12% in the third quarter. While we saw a slight acceleration in our MSP business as a result of COVID-19, our most recent trends indicate that the MSP market is beginning to reaccelerate. Notably, ARR growth in the third quarter was a couple of percentage points higher than our MSP business revenue growth.

In addition, despite the difficult economic environment, our net retention rates have held up well and remained at approximately 107% on a trailing 12-month basis both on a reported and constant currency. However, due to the deceleration we saw around our MSP business in the second quarter, we expect net retention rates to drop slightly in the fourth quarter before beginning to improve in early 2021.

Now I'll turn it back to Bart to take you through our total company outlook for the fourth quarter and the full year.

J. Barton Kalsu
Executive VP, CFO & Treasurer

Thanks, John. Before I get into the details of our outlook, as Kevin talked about, we recently signed a definitive agreement to acquire SentryOne.

SentryOne fits the profile of companies that our core IT management business will focus on acquiring in the future. We expect our GAAP revenue to be in the mid-$20 million range in 2020 with a growth rate in the low double digits, which was impacted by the headwinds from the economic slowdown caused by the pandemic. However, we expect our total revenue growth to accelerate in 2021 compared to the 2020 forecasted results. And over the long term, we believe this acquisition will not be dilutive to our consolidated adjusted EBITDA margin. We expect SentryOne to close this week and to contribute approximately $2 million of GAAP revenue in the fourth quarter, which reflects the impact on revenue of the adjustment to reduce the beginning deferred revenue balance required by purchase accounting and to be approximately breakeven on a GAAP basis for the fourth quarter.

Turning to our outlook. And a quick reminder, our outlook assumes a euro to USD exchange rate of 1.17 and a British pound to USD exchange rate of 1.30. For the fourth quarter of 2020, on a non-GAAP basis, we are increasing our outlook due primarily to the SentryOne acquisition and now expect total fourth quarter revenue to be in the range of $261 million to $266 million, representing a year-over-year growth of approximately 5% to 7% on a reported basis. This fourth quarter outlook assumes a maintenance renewal rate in the 92% to 93% range and a consolidated fourth quarter net retention rate of approximately 104% on a trailing 12-month basis.

We are also increasing our fourth quarter adjusted EBITDA outlook and now expect a range of $123 million to $126 million for the fourth quarter or an adjusted EBITDA margin of 47.4% at the midpoint, which results in earnings per share of approximately $0.25 per share for the fourth quarter assuming a weighted average number of shares outstanding of approximately 317.5 million shares. Our earnings per share guidance assumes a non-GAAP effective tax rate for the fourth quarter of 2020 of approximately 22%.

Based on our results for the third quarter and our outlook for the fourth quarter, we are raising our outlook for the total non-GAAP revenue and adjusted EBITDA for the full year 2020 as follows. For the full year December 31, 2020, on a non-GAAP basis, we are increasing our outlook for total net -- total revenue as a result of the revenue fees in the third quarter and the SentryOne acquisition and now expect total revenue to be in the range of $1.017 billion to $1.022 billion, representing year-over-year growth of 8% to 9% on a reported and constant currency basis. The full year revenue outlook assumes a maintenance renewal rate in the 92% to 93% range and a subscription net retention in the range of 103% to 104%.

We are also raising our adjusted EBITDA outlook for the full year to a range of $486 million to $489 million, which results in earnings per share of $0.98 per share for the full year assuming 315.5 million shares outstanding on a weighted average basis. Our earnings per share guidance assumes a non-GAAP effective tax rate for the full year of 2020 will be approximately 22%.

And with that, I'll now turn the call back over to Kevin.

Kevin B. Thompson
President, CEO & Director

Thanks, Bart. As you can see from our third quarter results and our fourth quarter and full year outlook, our confidence in our ability to deliver continued growth despite the difficult economic environment has increased as we've moved through the last 2 quarters. For the first 9 months of 2020, we've been focused on taking market share in our key markets. Based on International Data Corporation's Worldwide Semiannual Software Tracker, for the first half of 2020, we successfully increased our industry-leading position in the network management market by about 2 full percentage points to 22.9% market share.

We believe we can further increase our market share over the next several quarters in not only the network management market, but in all of the key markets where we compete today by leveraging our strong product portfolio and disruptive go-to-market approach as CIOs and MSP business owners look to reduce IT spend while increasing the level of performance and availability of the infrastructure and applications for which they are responsible.

We also believe based on the trends in our business, several of which Bart and John discussed in their remarks, that the small- and medium-sized business market, which has been remarkably resilient so far in this economic downturn, is beginning to show signs of acceleration, which we expect to continue through the fourth quarter and into 2021. In addition, in our core IT management business, we retained stable and improving spending trends from our enterprise customers as evidenced by the continued double-digit growth in a number of our large customer relationships.

Now I want to provide an update on the strategic process which our Board previously authorized and we disclosed on our second quarter call to explore a potential spinoff of our MSP business into a newly created and separately traded public company. Based on the additional work we have done over the last 90 days, we continue to believe in the rationale for the separation from strategic operational business growth and value creation perspective as the separation of the MSP business from SolarWinds will create 2 independent companies that are both market leaders, each focused on their different businesses, customers and strategic initiatives. In addition, each business would have the freedom to develop investment plans unique to the dynamic and maturity of the markets which they serve. Under the direction and oversight of our Board of Directors, over the last 3 months, we've been reviewing the businesses and related considerations in that in developing detailed plans to separate the 2 businesses into separately traded public companies.

Based on the work done to-date, it is our intent to proceed forward with the separation process although the structure and timing of the transaction still must be finalized. We expect that the spin-off of the MSP business, if they receive final approval by our Board of Directors, would incur during the first half of 2021. However, there is still a number of legal, organizational and operational items that must be accomplished over the coming months to finalize the definitive proposal for final separation for approval by our Board of Directors.

The last item for which I'll provide an update is the status of the CEO search for SolarWinds. First, as a reminder, John Pagliuca, who is on this call, will be the CEO of the MSP business should the spin-off transaction be completed. Therefore, we are currently searching for a CEO to lead the core IT management business. We've engaged an outside executive search firm to lead this search, and they have presented a number of qualified and interested candidates to the search committee of our Board of Directors. The search committee has interviewed several candidates and believe that the pool of interested candidates is of high quality.

Based on the quality of the candidates that have been interviewed thus far, we hope to be able to complete the search process in a relatively short period of time. Given that, this may well be the last earnings call which I will lead as the CEO of SolarWinds. For many on the call, we have known each other for my entire 14.5-year tenure at SolarWinds. And for some, we even go all the way back to my days at Red Hat.

For those in this room, isn't it amazing how fast 2 decades go by. I appreciate the level of your engagement and interest in the SolarWinds story over the last decade, and I do believe that we have created a very unique software company in SolarWinds. I hope you will continue to be engaged in the SolarWinds story in the years to come, and I'm certain we will run into each other again in the future as it is still a small technology world.

To the approximately 3,300 [Solaris] around the world, I will miss the way you have constantly challenged me. I will miss your energy, your enthusiasm and your ability to constantly pick yourself up and get back in the game when things did not go exactly the way we wanted them to. Thank you for believing. We have built a great company on the foundation of great products, digital marketing and a selling from the inside model when very few others believed that it was possible. Keep believing as there's still a lot of special things left to accomplish in SolarWinds. We are still the best story in software.
With that, Bart and I will open up the call for questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Brad Zelnick from Crédit Suisse.

Brad Alan Zelnick
Crédit Suisse AG, Research Division

And Kevin, your parting words that you just left us with, I mean, it sounds like the odds of you being on the next call are pretty slim, in which case, at least if we don't connect publicly in this kind of forum, I must say congrats on a phenomenal run. You've really been a standout leader not only for SolarWinds, but amongst all the companies we cover. So I truly wish you the best.

Maybe just on the business, if I could ask you, Bart, great to see the license trajectory improved, 10% down this quarter, better than where you were last quarter. And I totally understand there's some impact from the shift to on-prem subscription that you've called out. Can you just, a, remind us what portion of the on-prem offering is available as a subscription? Is that going to change over time and grow to encompass all the offerings and even beyond Q4? I heard your comments. But as we think about just on trend what that license growth rate should be and what the trade-off is, how should we even wrap our minds around that?

J. Barton Kalsu
Executive VP, CFO & Treasurer

So yes, as you said, Brad, we had a really solid quarter from a license revenue perspective and a noticeable improvement from what we saw in the second quarter. The subscription pricing that we rolled out in April covers all of our key products. So if I'm looking at it as a percentage of revenue, I haven't calculated it, but it would be a very significant majority, probably over 80%, 85% of our total license revenue products are now offered under a subscription basis.

So that's the shift that we're looking at. Like we said before, it's a transition for us. We're not looking to move our existing customers off of maintenance. They still have a lower price on their maintenance than they would under subscription. It's really centered around getting new buyers the alternative to buy under a subscription agreement.

Kevin B. Thompson
President, CEO & Director

And as it relates to kind of trends as we look into fourth quarter, what we're assuming right now, Brad, is that the trends in that part of the business in the fourth quarter are pretty consistent with what we saw in the third quarter, which is we had strength in certain markets. EMEA was very good in the third quarter. North America, including the impact of selling into state, local and federal government, was solid in the third quarter. Some of the other markets were not quite as stable yet. We're assuming we'll see that same variability in the fourth quarter. And that the kind of the economic environment, the level of spending from an IT perspective particularly in on-premise environment where we're really strong, will be consistent in the fourth quarter with the third quarter.

So we're not expecting any meaningful improvement in the fourth quarter. I do think moving into 2021, we will start to see improvement. We may see some in the fourth quarter. But as you know, the noise level in the market right now is kind of fluctuating back to a higher level of shutdowns may start to occur at a higher level in the fourth quarter than what we saw in the third. And so we try to bake all that into our view of the fourth quarter.

Brad Alan Zelnick
Crédit Suisse AG, Research Division

That's very helpful. And if I could maybe ask one of John. As it relates to the MSP business, you now have another company within the market that's now public with Datto. And I'd just be curious, what, if any, impressions do you have from their IPO process? And as well, just thinking about if you can educate us a little bit more on the finer points as to how SolarWinds is positioned against them in the market, that would be really helpful.

John Pagliuca
Executive VP & President of MSP

Yes. Sure. We're actually glad to see Datto have a successful IPO with respect to the Datto team and the business that they have there. They have a good business especially where they're focused, and they're primarily focused in the backup and disaster recovery space. So they've done a good job, I believe, educating the broader market, doing a good job kind of telling the story that our MSPs carry on every day. But where we actually find ourselves selling a lot of times with them, our MSPs will usually have the Datto offering and our offering at the -- in the same kind of environment as they manage and back up small and medium enterprises across the globe.

Kevin B. Thompson
President, CEO & Director

Yes, the thing to remember, Brad, I think we talked about this, is that we are really strong when it comes to remote monitoring management automation and helping our MSPs manage their customer environments, and we believe we've got the strongest [growing] platform and product portfolio there. We have great security technology. We have great remote monitoring and management technology obviously. As a business, we're really good at monitoring and managing performance of environment.

Datto really started as a backup company who bought a PS, professional services, automation company. And so that's where their strength is. We're strong in the different parts of the MSP market. So nothing we don't compete, but we're not direct head-to-head with them on a daily basis because our strengths are a little bit different. We do have backup. We have a really good cloud-to-cloud backup solution, which is growing very nicely for us, but they're more hardware-based. They are more environments that are not as cloudy as the environments we're in. And so while we compete in the market, we are relatively different 2 businesses today.

Operator

Your next question comes from the line of Sanjit Singh from Morgan Stanley.

Sanjit Kumar Singh
Morgan Stanley, Research Division

It will be a pretty strange feeling if Kevin's not on the next call. I can't imagine. Kevin and SolarWinds are like [indiscernible] like peanut butter and jelly. But I think probably your biggest accomplishment, Kevin, is creating a sustainable business, and that's exactly what you built, a business that generates tons of cash and grew double-digit in terms of ARR in the middle of a really challenging economic environment.

And so just to pick up on that last point, you sort of mentioned in your script, Kevin, about signs of acceleration. I was wondering if you could give us a little more detail on that, maybe sort of break it out by the MSP business, where are you seeing some of those sites as it relates to customer expansion and maybe whether it's churn or new customer acquisitions. If you could give us some more color there, that would be helpful.

Kevin B. Thompson
President, CEO & Director

Yes. So a couple of data points I mentioned there. Because I talk fast, sometimes you're lost, one of the things we saw in the third quarter was an improvement in sales into new customers. So that's one of the trends that we're seeing. We're seeing more businesses that have not been previously been customers of ours, which I know is hard to believe that everyone's not our customer given the number of customers we

have. We saw a nice increase in the number of new customers compared to the second quarter. We're not at all-time high or anything like that. We saw an improvement in the third quarter over the second quarter.

We also saw good spending levels by our larger enterprise customers. We closed a number of transactions signed in the quarter. Those transactions, not only did we close them, but they closed in the expected time frame, which for me is a sign that technology pros at least know what their budgets are now, which I don't think they really did in the second quarter. So while budgets may be down, in some cases, they at least know what they are. They know how to access them. And then we know what they're able to spend them on because we're seeing the activity have a more purpose to it and with the IT pros having a knowledge of what they could spend and the time frame they can spend it in.

The other thing we are seeing is we're seeing an increase in just the level of activity, meaning [indiscernible] products, online [quotes], people downloading and reading white papers, calling in and talking to us. So that activity level is starting to pick up again. So our reps are able to have more conversations in a day, week, month, quarter, which is another sign that at least things are starting to return to normal a little bit. Technology pros have the time of the day now to look for solutions that make their lives better, to make their businesses run more effectively.

But on the MSP side, particularly in our larger MSPs, we're starting to see device growth again. We're starting to see them look at expanding the number of services they're offering to their end users. So they're looking at, a, I don't provide a [indiscernible] protection to this customer today. Let's talk to them about it, and let's provide it to them tomorrow. Some of our newer offerings are starting to accelerate again. And then even with our small business -- very small MSPS, and there are a lot of very, very small MSPs in the market, but that's probably another place we differentiate from Datto, going back to the earlier question, we serve MSPs of all sizes, from 2 guys and a dog in a garage, or one guy and a dog in a garage for that matter, to USPs that have 100 technicians. In those really small MSPs where we saw devices really dropped a good bit in the second quarter or early third quarter, we've seen stabilization. We see that device count gets stable.

Now we haven't seen it start to grow really quickly yet, but we have seen stability. So those are the signs that we look at across the business both in our small business customers as well as our large enterprise customers that tell us that while the economy is not in a great place, I think we all agree to that, there's still some instability, still some uncertainty, I think there's more consistent activity and consistency in spending on what we were seeing before.

Sanjit Kumar Singh
Morgan Stanley, Research Division

That's great detail, Kevin. And then maybe one for John, just thinking more broadly as we think about the potential strategic spin-off later in 2021, it looks like. If you look at the growth profile of the business, John, it's sort of been sort of 12% in the most recent quarter, but kind of mid-teens and then an expansion rate -- a net expansion rate of in the sort of 105% to 108% range. In terms of if you wanted to grow the business faster, what would be the growth vectors that you'd be targeting? And like -- and what would be the sort of the key [unlevered income before it] actually grow? Is this a function of more investment equals more growth? Or do you take the product portfolio into new areas? If you can just sort of frame out the growth opportunity for us, I think that would be super helpful.

John Pagliuca
Executive VP & President of MSP

Sure. We talked a lot about some of the reasons for the spin. And for the MSP business, it's really the increased investment in a couple of areas around R&D and around our customer success initiatives. So Kevin mentioned that some of our newer products are catching some great momentum with our cross-selling with MSPs both small and large. So what you see is an increased investment in -- but more frequent addition to offerings to our MSPs that they can go and make sure that they're securing and managing these small and medium enterprises. So that's a big trend.

And then the second one is along customer success. What we're finding is introducing more humans in the loop, Kevin talked about the MSPs being from one guy with a dog in the basement to $1 billion enterprise, well, they have different needs and they need different touch points and type of customer success. So we'll be investing in that area to make sure that we're providing a little bit more of a bespoke level of service to these different types of personas that we have in our business.

Operator

Your next question comes from the line of Rob Oliver from Baird.

Robert Cooney Oliver
Robert W. Baird & Co. Incorporated, Research Division

And just wanted to echo the comments, Kevin. Best wishes to you and your retirement. Somehow I thought it's going to end up being that. Still trying to [chase the pelican], and I imagine that gap's going to widen when you have more free time. But...

Kevin B. Thompson
President, CEO & Director

[indiscernible] a lot.

Robert Cooney Oliver
Robert W. Baird & Co. Incorporated, Research Division

Yes, you're tough to catch up with. So just a couple of quick questions for me. One, on the subscription side of things, just curious, it sounds like you guys are off to a good start with the Orion core products being sold into new customers as an offering. Is that where we are seeing the subscription momentum right now? I guess would love to get an update since we didn't -- you guys had a lot to talk about on this call. We didn't hear much about, say, ITSM observability. And just curious, particularly given the tough macro where some of your price points might really play into the hands of people. Particularly, I'm thinking about Samanage and others. And I had a quick follow-up as well.

Kevin B. Thompson
President, CEO & Director

Yes. So our -- if you look at that cloud product portfolio we have and the core IT management part of the business that manages new applications, manages the log management of those ITSM and cloud, we're seeing consistent performance there. We haven't seen an acceleration as a result of COVID, but we haven't really seen much slowdown in revenue growth either in that part of our business as a result of the pandemic. I do believe we've got a good technology. We've got intelligent price points.

As we indicated back a couple of quarters ago, we have reduced the amount of marketing spending and overall go-to-market spending on that set of product not because we don't believe that ultimately it's going to be a large opportunity just because we believe we're still early, and we don't want to get into spending war with the other players in that market around spending on [20, 30 to 1] right now. It's just not the way we go in into market. So performing fine, performing consistently, not getting an acceleration. We didn't really expect it to. We didn't build that into our outlook. So performing consistent with how we would expect them to perform.

I think the growth in subscription revenue is being driven by a lot of different factors. One is [because of pressure]. Two, yes, we're starting to sell a decent dollar amount, still small as a percentage of total sales of our Orion family of products, but a decent dollar amount and growing in dollars. We've doubled sequentially Q2 to Q3. We think we'll see another meaningful level of growth sequentially from Q3 to Q4 in sales and subscription offerings to those -- that product group.

And maybe a thing to remember is we do recognize some amount of that revenue when we sell one of those on-prem products in the form of subscription. We recognize some of that upfront immediately as in subscription revenue. [We'll get not a very big] dollar amount yet, but that is helping start to accelerate

that subscription revenue growth and should be an accelerator of subscription revenue growth for our core IT business for quite a long time to come.

Robert Cooney Oliver
Robert W. Baird & Co. Incorporated, Research Division

Great. And my follow-up was on -- just on SentryOne. You -- just wanted to dig in a little bit more on the thought process there. Was it the ability to kind of get product at the Infrastructure as a Service players? What was it? And what is it in the product portfolio that you guys were most attracted to?

Kevin B. Thompson
President, CEO & Director

Now the interesting thing about SentryOne is that they complement our product offerings in a really interesting way. There's very, very little overlap. They really fit nicely to the overall portfolio. They've got a number of tools that they sell to a database developer, and they really are focused on the Microsoft environment, so Microsoft SQL Server, Microsoft Manager SQL, Microsoft Data Platform. They're really burrowed in that Microsoft world, and they focus on building great relationships with that Microsoft database admin. And they have those tools which we really don't have. They've got monitoring capabilities that we did not have. They got deeper monitoring capabilities than the ones we have. And the team there has a tremendous level of expertise in database management in general and then specific in that Microsoft environment.

So bringing their team together with our team, we think, creates a pretty powerful combination. And by adding their product portfolio to ours, it now fills in a lot of the gaps we had in providing solutions to database developers and database administrators really without regard to where they're deploying their technology, whether it's deployed in the cloud or whether it's deployed on-premise. So it really does give us a very, very broad set of database management capabilities.

We don't think anyone else in the market is really even close in terms of the breadth of coverage we have. You name a database, you name a deployment model, we now provide not just some level of monitoring and management, but a deep level of monitoring and management. And we can do that on-premise. We can do that now in a hybrid world. We can do that from the cloud, and we can manage things in the cloud. So it really gives us a very comprehensive suite, kind of like what we developed in the network management market, right? We manage everyone's network gear. We manage all the aspects of that gear. We have really no meaningful gaps in our ability to manage network environments of organizations of all sizes and all deployment models. We are now going to be in a similar position in terms of database management.

Operator

And your next question comes from the line of Matt Hedberg from RBC Capital Markets.

Matthew George Hedberg
RBC Capital Markets, Research Division

And I'll obviously echo everybody's comments. Kevin, it's been a great run, and I'm sure we'll see you again maybe in the near future. John, I'm curious, you had some positive comments on the reacceleration of the MSP business. I'm curious about the growth dynamic when you think about adding additional MSPs versus selling more products through -- to your -- to their SMB customers. What's the right algorithm to think about those 2 variables?

John Pagliuca
Executive VP & President of MSP

Yes. So our model is pretty dynamic in that we grow, obviously, when we add MSPs, and we spend a good amount of effort there. But a lot of our -- for both internally, and that's why we're flexing up on our customer success is to really help these MSPs win and grow their business. The power metrics get obviously much larger out -- the further out we go, right? So we're managing millions of devices, and we're managing hundreds of thousands, over 500,000 small/medium businesses.

So the more that we can do to have those MSPs successfully manage and secure those small/medium businesses, that's really where a highly leveraged model really starts to play. So as we introduce more offerings for those SMB -- excuse me, those MSPs to offer to the SMB and provide a service around, that for us is a pretty profitable kind of return on our investment.

Kevin B. Thompson
President, CEO & Director

Yes, Matt, if you remember, we talked about at the beginning of 2019, one of the changes that John and the team made is we moved away from just focusing on the number of MSPs we're adding. And we started focusing on the healthy MSPs we wanted to add to our family of MSPs and then focused on growing them. So that's -- when I say that, that doesn't mean we're only chasing large MSPs. We're not. We're chasing healthy small MSPs, healthy midsized MSPs, healthy large MSPs and then we're making sure that they grow over the term of their relationship with us.

And if you remember, we talked about the fact that we even changed our sales rep compensation plan so they live with the MSPs they bring in for the first 6 months of their relationship with us. And we built it in their quotas and expected growth in that relationship. So you can't just land them and run away and land the next one anymore. You've got to make sure you're making them successful.

So I think that really goes to John's comment of we're making sure that the MSPs we land, grow. We want to add a bunch of new MSPs, but we won't -- but that, by itself, is not the right equation. The algorithm is land MSPs we can grow. And it doesn't matter how big they are when we land them as we land MSPs that can grow, and then we got to make sure we help them grow.

Operator

Your next question comes from the line of Kingsley Crane from Berenberg Capital Markets.

William Kingsley Crane
Joh. Berenberg, Gossler & Co. KG, Research Division

And likewise, I want to congratulate both Kevin and John. I just have one quick one follow-up on the SentryOne acquisition. So given the breadth of the capabilities you're acquiring here, including features in categories like data ops and cloud migration, how might these fit into the existing SKUs between DPA and DPM? Or perhaps they're entirely new SKU?

Kevin B. Thompson
President, CEO & Director

Yes. So look, I think you should expect, one, there will be a lot of [entirely new] SKUs. They have a great product set. Their products have been well packaged. They've thought -- been very thoughtful about how they combine a set of features, put that in a SKU and provide those set of capabilities to their customers. They have a really great knowledge of their customers and what their customers need and what their customers want because they've been really focused on database management, particularly those in the Microsoft world for a number of years now. So we think the way they package their products, for most cases, fits really nicely into our model.

Now without a doubt, we will find a new way to package the capabilities we have with the capabilities they have because they do provide features that we don't have that close gaps in some of our products and give our customers the ability to solve some problem. We're not giving them the ability to solve very effectively [with edge]. This combination of bringing their SKUs to market pretty much the way they have them and then us figuring out ways to combine the products into a "bigger" offering, if you will, that solves a broader set of problems if you know how to price them.

But initially, we're going to let them keep running because they've done a great job of building a great business. And then we'll gradually figure out how we bring value to their team by giving them access to our customer base, by giving them access to our development team, by finding ways to combine the technology.

Operator

Your next question comes from the line of Terry Tillman from Truist Securities.

Terrell Frederick Tillman
Truist Securities, Inc., Research Division

Kevin, congrats from me as well, and we will miss you and I'm sure you're going to miss our amazing questions. I was a good listener, all the way back to the Red Hat days. I was a good listener, so I'll just ask one question. On the federal government, with September year-end, what kind of observation can you make about the federal government in the quarter and just kind of the signals you're getting out of the public sector in general?

Kevin B. Thompson
President, CEO & Director

So the public sector has been interesting over the last 6 months. I think the federal government, so that part of public sector, has been strong, has been consistent, has been predictable, at least as predictable as that part of the market ever get. As you guys know, the federal buying process is a little bit obscure. It requires a little bit of witchcraft to really understand it. But we've got a good team there and very experienced over the long time. They do a good job of managing that process. So buying activity there has been good. We've got a very, very strong customer base there. We have had for a long time. We are embedded in a number of projects where our customers continue to buy on at least an annual basis; in some cases, more often. So that part of the market has been good.

State and local has been a little bit variable. On the education side, not great. It's been a little bit slow and kind of up and down. School systems have been struggling with a lot of things. As you got to know, with most of the students being online and now hybrid and now some back in the classroom [as they send them] back home, the budget there had been a little bit hard to access. But the team has been performing probably as well as to be expected in that environment. State, a little bit better. So the state and federal is where you see more strength. Kind of local and education, you're seeing a little more weakness.

Operator

Your next question comes from the line of Erik Suppiger from JMP Securities.

Erik Loren Suppiger
JMP Securities LLC, Research Division

Again, congrats on moving on. A question on Orion. As -- with your existing customers, as they purchase new or add-on business, are they doing that with subscription business? And if that's the case, then does that ultimately lead to a deceleration in your maintenance business?

Kevin B. Thompson
President, CEO & Director

So the answer is it won't result in a deceleration in our maintenance business. If you own a license from us, you've always gotten all the same things you would get from a subscription relationship, which is every release we ever do [indiscernible], [you just get it all if you're active] on maintenance. So we don't expect to see customers transition from maintenance to subscription based on the pricing model that we have in the market today because it's still less expensive for them to stay on that maintenance relationship. And there's nothing new they'd get by moving to subscription [related to] that. That could change in the future, but today, you should not expect that.

Now do we see some of our customers who bought licenses in the past buying subscriptions when they come back to buy new products they don't own? Well, let's say they own APM, but they don't own NetFlow, they don't own SAM and they come back to buy NetFlow and SAM. In some certain cases, we are seeing them make that purchase of an additional product in the form of a subscription. But the majority of the time, if they own a license, then they're buying licenses. Most of the sales of subscriptions have come

in to new customers so far, not all. And I do think we'll see more and more of our existing customers buy subscriptions to add to the licenses they already own just because those budgets are available to them. And what we've always tried to do is make sure that we are as frictionless as possible and we make it easy for our customers to buy. So if they want to buy a subscription and take that subscription product and integrate it with their license product, they can absolutely do that.

Operator

Your next question comes from the line of Sterling Auty from JPMorgan.

Unknown Analyst

[indiscernible] on for Sterling Auty. So it's looked like your customer additions improved in this quarter. Is that the case? And what do you expect to happen from here given the macro backdrop?

Kevin B. Thompson
President, CEO & Director

Could you repeat the question? I didn't hear the first part of it. You're breaking up just a little.

Unknown Analyst

Okay. So it looks like your customer additions improved in the quarter. Is that the case? And what do you expect to happen from here given the macro backdrop?

Kevin B. Thompson
President, CEO & Director

Yes, so I think the growth in the quarter, one thing we mentioned is we saw acceleration in the number of new customers we were adding sequentially. That doesn't drive a tremendous dollar amount of revenue growth right away because most of the new customers start relatively small. That's true in MSP business. That's true in the core IT management business. It's true with our cloud management product. Most customers are relatively small. We saw good customer retention [indiscernible]. Our renewal rates stayed strong. Our net retention rate stays stable. That helps drive growth.

As I look forward at the fourth quarter, I do expect we'll continue to see some momentum in new customer addition. I think that customer retention will continue to be strong. And I think we will begin to see a little more rapid pace in which our customers are growing their relationships with us. John mentioned on the MSP side, our larger MSPs are beginning to see device growth, which means they're paying us more money. On the large enterprise side and core IT management, we're seeing good momentum in terms of customers expanding in a meaningful way their relationships with us.

So it's really the combination of all of that, that helps drive our overall revenue growth. We're not really fully leveraged to one or the other, though customer transactions tend to be larger. And so we're going to see more growth in dollars from customers even if we don't see more growth in percentage.

Unknown Analyst

And a quick follow-up, if I can. Sir, in light of looking to split the company, has there been any pushback from new or existing customers?

Kevin B. Thompson
President, CEO & Director

No. We haven't heard anything from our customers about the potential split of the business. I think it really comes down to the fact that we've been running the business in 2 units for a while now. The MSP market is a very, very specific market. It requires a very specific engagement model. We do digital marketing and selling from the inside. We leverage a lot of our best practices. The way we engage with an MSP partner is very different than the way we engage with a corporate IT buyer or a DevOps buyer. So reality is those 2 different parts of our customer base, they don't care about each other very much. And

they're not using -- they're not really cross using products out of the 2 different product portfolios. So we haven't heard any noise at all from our customers about this potential split.

Operator

Your next question comes from the line of Mohit Gogia from Barclays.

Mohit Gogia
Barclays Bank PLC, Research Division

Kevin, I'll offer you my best wishes as well as you look ahead to a professional career outside of SolarWinds maybe. So staying on the topic, Kevin. So earlier in the year, I think we discussed around some sort of like initiatives around maybe you're going to look to sell -- cross-sell [indiscernible] in the MSP base, but even outside of that, right? So I'm assuming, as you go through the discussions of separating the 2 businesses, there are maybe certain synergies, maybe on the product R&D side, maybe on the go-to-market side. How do you sort of like think about those synergies, if there are? And maybe as 2 separate, just making sure that no dissynergies that happen as a result of the separation.

Kevin B. Thompson
President, CEO & Director

Yes, look, without a doubt, we have shared technology between the product portfolios over time. And one of the things we're making sure we do as part of the process of looking at how we would separate these 2 businesses is making sure that both businesses get all of the IP, if you will, that they need to accomplish the things they need to accomplish in the future. So if we believe that a certain IP that exists [on core IT] management business that the MSP business needs to be successful, we'll make sure that we cross-license that so they continue to have access to it if they're selling it already. If they're not selling it already but they believe it's strategic to them, we'll cross-license it so they [can and] going the other direction also.

So not worried about technology dissynergy because, one, we've done a lot of the work that we needed to do to share technology between the product portfolios and the product platforms. And we've got a good view, we believe, of what will need to be done in the future. So we'll be able to handle that in a way that we create the separation, the way we create IP licensing between the 2 businesses and also the way we build the transition services agreement between the 2 businesses to make sure we maintain the momentum in both. So not really worried about that. I think we've got a good handle on it. We've got a good plan. We've got a good visibility on what we want to do.

On the go-to-market side of the house, the reality is that what we've really worked hard at over the last 4 years is to create a set of best practices that we're leveraging across our global business. And the key is to make sure those best practices [indiscernible] in each of the business units. We believe that they have. And so we have a separate go-to-market team for MSP, a separate go-to-market team for the core IT management business. We share a lot of the same processes and practices and methodologies, but those will continue to be used by both businesses when we split into 2 separate companies.

So there's not a loss of a capability from a go-to-market perspective when we split because we have shared those capabilities so all the teams have that expertise, they have those processes, they have those methodologies. So there should be no slowdown as a result of the split.

Operator

And your last question comes from the line of Brent Thill from Jefferies.

Luv Bimal Sodha
Jefferies LLC, Research Division

This is Luv Sodha on for Brent Thill. Congrats, Kevin, on a great impressive run and wish you all the best for the future. I wanted to ask one quick one on the margins. Obviously, impressive margins this quarter. But some -- you mentioned some commentary that the go-to market, you're planning to increase

investment in terms of headcount next quarter. Sort of what is this investment sort of focused on? And as we look out to 2021, what do you expect in terms of margins?

Kevin B. Thompson
President, CEO & Director

Yes. The comment on headcount was not limited to go-to market. We have been very, very careful about adding resources over there in the last 6 months, one, because we are all working from home. And when we add people, we want to make sure they're productive. So we've slowed down the rate in which we've been hiring to make sure that in a [indiscernible] world, that we can do a good job [a lot more than] training and getting people productive right away. So not just go-to market where we will hire a little bit more in the fourth quarter than we did in the second and third quarter. Go-to market is one of the areas, but also R&D, also kind of our back-end system team. MSP business, we've talked about, is going to -- as part of the separation process is looking to invest more heavily in product, more heavily in customer success. We're doing some of that hiring now.

So it's really across a number of areas where we expect to hire more. And I use the word expect because with hiring, you never know exactly how it's going to go. And there are a couple of holidays in the fourth quarter, which sometimes makes it a little more difficult to hire. But our expectation is we'll add more people to the team in the fourth quarter than we had in the third quarter. Obviously, we have the impact of the SentryOne acquisition that we expect to run at breakeven on a GAAP basis in the fourth quarter. So that breakeven will bring our overall EBITDA margin down a little because breakeven doesn't equal 51%. So that has a little bit of an impact.

And on the go-to-market side, it's really making smart marketing investments and spending money where we're seeing return. We pulled back in our variable spending in marketing in the second quarter and the third quarter because of a view that we could spend a lot of money and maybe get clicks. But then the people would click and not have the ability to buy. And we still pay the money when they get to click, whether they have the ability to buy or not. As I indicated in my comment, we think the IT pros, DevOps pros, MSPs have a better view today than they did 3, 4 months ago of the money they've got available to spend. They've got a better view of the stability and performance of their own business.

So they've got more intent to buy now when they engage. So we're willing to ramp our spending back up a little bit. We're still going to be very, very profitable in the fourth quarter, still really even more profitable than probably what we set out at the beginning of the year for the fourth quarter. We just had an extraordinary level of profitability we delivered in the third quarter.

And I think with that, operator, we're going to wrap the call up. We appreciate the questions and the attention. And thanks for being on the call.

Operator
Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.